# MERGER OF CANADIAN PACIFIC AND KANSAS CITY SOUTHERN RAILWAYS



Dr. Malcolm Cairns
Malcolm Cairns Research and Consulting

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# Outline (2)

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# Map of CP and KCS



# General Overview

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- The merger would require no government financial assistance
- It would create the first railway in North America to serve Canada, the US and Mexico
- CP and KCS currently connect only at Kansas City so the merger would be end-to-end
- A merged CP and KCS, to be named CPKC, would still be the smallest of the Class 1 freight railways
- CPKC would have some 20,000 miles of road, employ some 20,000 people, and generate revenues of $8.7 billion
- No rail lines would be discontinued or facilities rationalized
- More than 960 stakeholders – shippers, smaller railways, ports, rail unions, rail industry suppliers – have written letters of support

# Procedures and Approvals

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- The merger has received approval from the required Mexican authorities, and does not appear to require approval in Canada
- CP has already acquired KCS under terms fair to the shareholders, and the shares were placed in a Voting Trust to ensure KCS will operate independently of CP until the US Surface Transportation Board (STB) issues its decision on the joint railway control application – expected in early 2023
- The STB has determined it will conduct its review under earlier merger rules and will not require "enhanced" competition
- A safety integration plan submitted to the STB and the Federal Railway Administration (FRA) has been approved by the FRA
- The Office of Environmental Assessment at the STB has issued a positive draft Environmental Impact Statement and is conducting public hearings
- Meanwhile, the merger receive regulatory clearance from the Committee on Foreign Investment in the US
- It remains for the STB to determine whether the merger is in the public interest

# Collateral Issues - Employment

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- Annual personnel savings in General Administration will be achieved by consolidating CP's and KCS's headquarters for US operations in Kansas City and closing CP's US headquarters in Minneapolis
- There will be one-time separation costs for 92 non-union employees in Canada and 112 non-union KCS employees
- There will be one-time relocation costs for the relocation of 135 non-union KCS employees
- There are no anticipated separations for union employees at CP in the US, or for union employees of KCS in the US or Mexico
- Upon consolidation of CP and KCS there is the expectation of over 1,000 new jobs to accommodate traffic growth, with over 750 of these in the US
- This increased employment is identified as serving the public interest

# Collateral Issues – Integration of Information Technology (IT)

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- The CP and KCS application provides some detail on how there is advanced IT planning to ensure no disruptions after approval – as there were in several past railway mergers
- System integration will take place in stages
  - Service Design will be implemented immediately
  - Other IT systems will be implemented as they are required and available over a 3-year period
  - IT systems in Mexico will remain unchanged
- Over the three years of IT integration, there will be \$139 million of capital expenditures and \$62 million of capital savings
- Post integration there will be annual capital savings of \$22 million
- These changes will serve the public interest by providing benefits to shippers through greater operational efficiency and the provision of more rail performance information

# Collateral Issues – Safety

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- CP has achieved the lowest FRA train accident frequency of all large railways for 15 years, and has achieved steady improvement  in the FRA personal injury frequency
- CP has outperformed KCS on safety and, upon merger approval, will export its safety culture to KCS operations
- The superior safety performance of CP has been achieved through significant investment in technology
  - “above-the-wheel” technology to reduce potential accidents, such as wheel life forecasting
  - “below-the-wheel” technology such as broken rail detection
- These safety technologies will be rapidly deployed across the CPKC system
- It is in the public interest to the general public and shippers that the merger will contribute to safer railway operations in the US

# Collateral Issues – Capital Expenditures on Line Capacity

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- Exhibit 1 outlines the capital expenditures on line capacity in the US to relieve bottlenecks and accommodate traffic growth
- Projects involve new sidings, siding extensions and centralized traffic control (CTC)
- These will serve the public interest by providing improved service to shippers

| EXHIBIT 1 | Type of Projects | Capital - Millions | | | Total |
|---|---|---|---|---|---|
| Subdiviisons | | 2023 | 2024 | 2025 | |
| | | | | | |
| Chicago | New siding | $8.5 | $0.8 | $7.67 | $16.94 |
| Marquette | New siding, CTC | $56.2 | $17.7 | $25.52 | $99.39 |
| Davenport | Siding extensions, CTC | $14.6 | $12.8 | $1.77 | $29.16 |
| Ottumwa | New siding, siding extension, CTC | $24.2 | $18.2 | $6.00 | $48.40 |
| Larado | New siding, siding extension, CTC | $39.2 | $12.9 | $6.29 | $58.38 |
| Kansas City | New siding, siding extension | $14.9 | $14.9 | | $29.82 |
| | | | | | |
| **CP Total** | | $157.6 | $77.3 | $47.3 | $282.1 |
| | | | | | |
| Pittsburg | Double track, siding extension | $42.9 | $10.0 | $15.00 | $67.94 |
| Heavener | New siding, siding extension | $40.9 | $5.4 | $24.40 | $70.65 |
| Shreveport | New siding, siding extension | $21.6 | $2.0 | $19.63 | $43.27 |
| Beaumont | Siding extension | $13.4 | $8.8 | $4.63 | $26.84 |
| | | | | | |
| **KCS Total** | | $118.9 | $26.2 | $63.7 | $208.7 |
| | | | | | |
| **Grand Total** | | $276.4 | $103.5 | $110.9 | $490.8 |

# Collateral Issues – Passenger Rail Service

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- CP hosts passenger rail services to commuters in Chicago and inter-city passengers on Amtrak
- CP has received a grade A rating from Amtrak for 4 straight years to 2020
- CP states that it will not interfere with the continued operation of these services, and will operate to avoid any impacts on passenger train performance from increased freight traffic
- CPKC will facilitate Amtrak's planned expansion in its Connect US plan
- This will involve
  - Increasing passenger train frequency between Minneapolis and Chicago
  - Increasing passenger train frequency between Milwaukee and Chicago
  - Establishing a new passenger rail service between Baton Rouge and New Orleans
- Providing benefits to rail passengers through increased and new services is in the public interest

# Collateral Issues – Trucking



- After exhaustive analysis, CP and KCS estimated that, from improved single line service previously unavailable, and the avoidance of interline costs and delays, the merger will create annual diversion from trucking of 64.000 trailers or containers to CPKC rail intermodal service
- The diversion to rail is expected to reduce long-haul truck miles in the US by 86 million, while requiring an additional 3.4 million miles in local dray
- The reduction in long-haul truck miles in Canada is expected to be 2 million, and in Mexico 15 million, with only a small increase in local dray in each country
- The public interest in diverting traffic from truck to rail is addressed in the next slide

# Collateral Issues – Environment

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- The specific environmental issues addressed in the application, that arise from the merger, and serve the public interest are
  - Greenhouse Gas Emissions (GHG) reductions
  - Reduced highway costs
  - Reduced truck noise pollution
  - An acceleration of the shift of rail traffic from crude oil to a less hazardous alternative
- Within 5-years of operation CPKC is estimated to reduce **rail** GHG emissions by 380,000 tons from improved rail efficiency. In addition, the diversion of traffic from truck to rail will reduce **truck** GHG emissions by a further 65,000 tons
- Reducing the number of heavy trucks on US roads will reduce highway pavement maintenance, and also reduce noise pollution from those trucks
- The merger will also accelerate an ongoing shift, away from moving crude oil toward the movement of non-hazardous alternatives by removing the flammable diluent, by 30,000 shipments

# Truck Traffic Diversion to CPKC

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| EXHIBIT 2: Truck Traffic Diversions to CPKC. Lanes with in excess of $1 million in 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|
| SOUTHBOUND | | | | NORTHBOUND | | | |
| **ORIGIN** | **DESTINATION** | **UNITS** | **REVENUES** | **ORIGIN** | **DESTINATION** | **UNITS** | **REVENUES** |
| Chicago | Federal District | 1,419 | $2,597,838 | Coahuila de | Chicago | 1,405 | $2,265,115 |
| Chicago | Nuevo Leon | 4,401 | $5,341,211 | Coahuila de | Detroit | 1,054 | $2,084,311 |
| Chicago | Queretaro | 719 | $1,875,232 | Dallas | Detroit | 2,348 | $2,642,447 |
| Columbus | Nuevo Leon | 1,568 | $2,546,908 | Dallas | Minneapolis | 6,586 | $5,532,974 |
| Columbus | State of Mexico | 951 | $1,865,083 | Dallas | Toronto | 1,339 | $1,923,425 |
| Detroit | Guanajuato | 722 | $1,449,939 | Federal District | Chicago | 1,353 | $2,478,570 |
| Detroit | Queretaro | 1,113 | $3,254,770 | Federal District | Detroit | 598 | $1,390,174 |
| Edmonton | Dallas | 520 | $1,070,961 | Guanajuato | Detroit | 870 | $1,753,318 |
| Minneapolis | Dallas | 6,586 | $5,571,294 | Nuevo Leon | Columbus | 579 | $1,017,676 |
| Minneapolis | San Antonio Tx | 2,105 | $2,501,884 | Nuevo Leon | Detroit | 1,307 | $2,171,856 |
| Toronto | San Antonio Tx | 583 | $1,066,438 | Nuevo Leon | Minneapolis | 1,646 | $2,719,302 |
| | | | | Queretaro | Detroit | 1,003 | $2,966,364 |
| | | | | San Antonio Tx | Minneapolis | 856 | $1,191,865 |
| | | | | San Antonio Tx | Toronto | 856 | $1,589,921 |
| | | | | State of Mexico | Columbus | 728 | $1,429,355 |
| | | | | State of Mexico | Detroit | 1,462 | $2,681,743 |
| | **Sub Total** | **20,687** | **$29,141,558** | | | **23,990** | **$35,838,416** |
| | **Sub Total S&N** | | | | | **44,677** | **$64,979,974** |
| | **Grand Total S&N** | | | | | **64,018** | **$98,155,376** |

- Commodity details are unavailable, but it is suggested that northbound shipments from Mexico include auto parts, hearty fruits and vegetables, and processed foods

# Rail Traffic Diversion to CPKC

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| EXHIBIT 3: Rail Traffic Diversions to CPKC | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| | | ($ millions 2019) | |
| **DIVERTED CARLOADS/UNITS** | | | |
| Automotive | 11,188 | 22,038 | 32,218 |
| Energy, Chemicals and Plastics | 16,343 | 19,207 | 21,143 |
| Forest Products | 2,100 | 3,961 | 4,616 |
| Grain | 4,984 | 10,365 | 15,768 |
| Domestic Intermodal | 45,336 | 90,708 | 137,416 |
| Metal, Minerals and Consumer Products | 0 | 2,257 | 4,514 |
| | | | |
| **TOTAL** | 79,951 | 148,536 | 215,675 |
| | | | |
| **INCREMENTAL REVENUES** | | | |
| Automotive | $42.3 | $84.2 | $127.3 |
| Energy, Chemicals and Plastics | $63.0 | $80.0 | $89.8 |
| Forest Products | $15.8 | $35.6 | $43.3 |
| Grain | $25.4 | $52.5 | $79.8 |
| Domestic Intermodal | $49.0 | $98.1 | $148.6 |
| Metal, Minerals and Consumer Products | $0.0 | $12.1 | $24.3 |
| | | | |
| **TOTAL** | $195.5 | $362.5 | $513.1 |

- Commodity details are available, but are too exhaustive to report here

# New Rail Traffic Markets for CPKC



- New traffic revenues were redacted from the public documents, but texts provide some indications
- **Automotive**: Created by investments in auto compounds on KCS lines to serve eastern and central Texas from the north and the south
- **Energy, Chemicals and Plastics**: Previously mentioned shift from crude oil
- **Grain**: CP lines in Iowa traverse fertile corn regions but CP's limited reach constrained investment. CPKC will invest to ship corn further to the south
- **Metals**: CPKC will provide new markets for recycled metal by providing additional export locations in the Gulf
- **Consumer Products**: CPKC will operate new transload centres with a broader reach for a wide array of commodities
- **Intermodal**: CPKC will have the opportunity to move international intermodal from Lazaro Cardenas in western Mexico to Texas, Chicago, Toronto and Montreal. A new opportunity will also follow investment in a new terminal in Beaumont, Texas to serve Houston from the east

# Operating Revenue Gains

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- Exhibit 4 summarizes the operating revenue gain over the first 3 years and normal year 2025
- The 2 shaded truck figures represent 50% and 75% of year 3
- With that assumption by this author, the 2 shaded new traffic figures may be inferred
- Lastly, by subtracting costs indicated in the application, net revenues can be determined

| **EXHIBIT 4: Operating Revenue Gains** | | | | |
|---|---|---|---|---|
| | | | | **Normal Year** |
| | **Year1** | **Year 2** | **Year 3** | **2025** |
| Truck Traffic Diversions | $49.1 | $73.6 | $98.2 | |
| Rail Traffic Diversions | $195.5 | $362.5 | $513.1 | |
| New Traffic | $173.4 | $290.6 | $410.6 | |
| Total revenues | **$418.0** | **$726.7** | **$1,021.9** | **$1,150.86** |
| Costs | **$129.2** | **$217.8** | **$306.3** | **$344.96** |
| Net Revenues | **$288.8** | **$508.9** | **$715.6** | **$805.9** |

Normal Year figures are determined, using an AAR Rail Cost Adjustment Factor, for net revenues in 2025 of $806 million

# Operating Savings and Total Net Benefit from Merger



| EXHIBIT 5 : Operating Savings | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | | Normal Year |
| | 2019 – $ millions | | Year 1 | Year 2 | Year 3 | 2025 |
| OPERATING SAVINGS | | | | | | |
| Train-miles | 21.82 | Mechanical | | | | |
| Locomotive r | 29.8 | – Locomotives | $19.58 | | | |
| Switching | 0.98 | – Switching | $0.31 | | | |
| Sub total | 52.6 | Sub Total | $19.89 | $19.89 | $19.89 | $22.40 |
| | | Transportation | | | | |
| Fuel | 26.57 | – Trains | $21.82 | $21.82 | $21.82 | |
| | | – Locomotives | $10.22 | $10.22 | $10.22 | |
| Equipment- I | 10.15 | – Switching | $0.67 | $0.67 | $0.67 | |
| Equipment – ( | 0 | – Fuel | $26.57 | $28.19 | $29.79 | |
| Subtotal | 10.15 | Sub Total | $59.28 | $60.90 | $62.50 | $70.39 |
| Purchasing | 4.18 | Equipment | | | | |
| | | – Locomotives | $10.15 | $10.15 | $10.15 | |
| | | – Cars | $0.00 | $1.79 | $2.60 | |
| | | Subtotal | $10.15 | $11.94 | $12.75 | $14.36 |
| | | Purchasing | $4.18 | $12.05 | $20.54 | $23.13 |
| Sub Total | 93.5 | | $93.50 | $104.78 | $115.68 | $130.28 |
| | | Support Functions (G&A) | | | | |
| | | – Personnel | $33.40 | $39.40 | $43.70 | |
| | | – Information Technology | $1.30 | $8.10 | $8.10 | |
| | | – Other | $1.30 | $3.50 | $5.20 | |
| | | Sub Total | $36.00 | $51.00 | $57.00 | $64.19 |
| Total Operating Savings | | | $129.50 | $155.78 | $172.68 | $194.47 |

- When Normal Year operating savings of $194 million are combined with net revenue gains from previous slide,  2025 total benefits are estimated at $1 billion

# Competition



- The analysis of competition by CP and KCS is exhaustive and best summarized in their own words
  - Because CP and KCS networks do not overlap, no shippers will face a reduction in competition
  - Nor will shippers face any reduction in routing options or confront any new bottlenecks
  - CPKC will have strong incentives to maintain all the efficient interline routes in which they participate today
  - CPKC will continue to support, both operationally and efficiently KCS's existing interline routes and CP's existing interline routes
  - CPKC will not hesitate to compete aggressively against interline routes where its new single-line routes offer advantages for customers in terms of better service or economic terms, or both. But CPKC will not prevail in this competition by closing off efficient interline routes that shippers may prefer in certain cases. Applicants' commitments to keep these and other affected gateways open both physically and commercially will assure that Applicants' incentives are backed up by the potential for enforcement under the auspices of STB oversight
- An evaluation of this is best assessed through the comments and request for conditions of the other Class 1 freight railways. Note that these other railways do not indicate that the application should be denied, unless their conditions are not met

# Comments and Requested Conditions - CN

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- CN comments negatively on the merger – saying the application is riddled with errors and inconsistencies, benefits are vastly overstated, and serious public interest risks are downplayed
- CN wants the KCS line to Springfield – which it accesses at E St Louis – divested to CN as its main condition to ensure the line's efficient utilization
- CN also wants conditions to prevent CPKC engaging in foreclosure, and for a service assurance plan with an oversight period of 5 years

# Comments and Requested Conditions - NS

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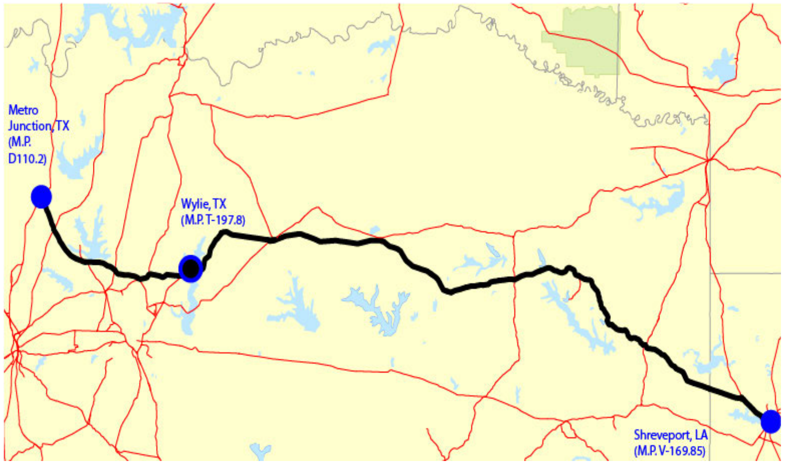



- The Meridian Speedway is important as the most direct route between the south-east and the south-west of the US. It is jointly owned by KCS (70%) and NS (30%), operated by KCS, and there is an interchange with NS at Meridian, Mississippi
- In addition KCS owns and operates the line from Shreveport, Louisiana to Metro Jct. Texas and the Wylie intermodal terminal is located on the line
- NS wants explicit commitments to keep the Meridian gateway open to NS, with efficient service over the speedway
- NS also wants contingent trackage rights from Shreveport to Wylie terminal

# Comments and Requested Conditions - CSX

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- CSX condition is that the exclusive right for NS to interchange intermodal traffic with KCS at Meridian forecloses competition and should be abrogated to provide CSX access to the Meridian Gateway on commercially reasonable terms. Moreover, that the NS condition seeking to expand its rights should be denied
- CSX also wants CPKC to continue to absorb the costs CSX incurs in using the New Orleans Public Belt railway, which was part of an earlier agreement, and that the agreement should be modified to be terminable only on mutual consent
- CSX wants CKCP – or CN – to maintain commercially reasonable rates and service levels for CSX on the Springfield subdivision between E St Louis and Kansas City
- CSX requests conditions to protect shippers from the risk that CPKC will abuse market power in Mexico to hurt competition, by requiring CPKC to provide shippers with sufficient information about their pricing and service plans for traffic to and from Mexico

# Comments and Requested Conditions - UP

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- It is the contention of UP that the merger would likely cause a substantial lessening of competition for traffic moving via the Laredo Gateway at the US-Mexico border, and that CPKC would have the ability to deprive shippers of the price and service benefits of UP routings
- In this regard UP requests that CPKC be required to offer reasonable Rule 11 rates based on a prorate of CPKC single line rates
- UP also requests that CPKC be required to comply with promises regarding Laredo Gateway operations and the Laredo Bridge made by KCS in the 2003 Tex-Mex decision at the time of the merger of UP and SP
- UP contends that the operations of CPKC would increase traffic over lines they share with other railways. Specifically
  - UP lines in the Houston Terminal Area, and in the corridor between Laredo and Beaumont, Texas
  - CPKC lines between Kansas City and Polo ,Missouri; in St Paul, Minnesota; and the Neche River bridge in Beaumont, Texas
- UP wants conditions that CPKC cooperate in determining investment needs in new capacity on these lines, commit their share of funding, and not increase traffic until capacity is in place – the STB to resolve disputes

# Comments and Requested Conditions - BNSF

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- In summary, BNSF concerns are the same as UP, about the Laredo Gateway, and its requests for conditions (Laredo is the largest rail crossing, 70% southbound)
- Specifically, BNSF wants to ensure that the open gateway commitment will function as intended by requiring CPKC to adopt a rate-setting mechanism, such as a proportional rate mechanism, that will ensure that BNSF will have access to Mexico through Laredo at market-based rates, as well as service commitments for equal treatment of BNSF's traffic into and out of Mexico through Laredo
- BNSF also contends that the operations of CPKC would increase traffic over lines they share with other railways. Specifically for BNSF
  - Ottumwa, Iowa – change the CPKC crew change location
  - The CP line between Davenport and Clinton, Iowa
  - Shared lines with BNSF on the Texas Gulf route
- BNSF also wants conditions that CPKC cooperate in determining investment needs in new capacity on these lines, commit their share of funding, and not increase traffic until capacity is in place
- Lastly, BNSF requests a 5-year oversight period, and that the STB reserve the right to impose further conditions, including trackage rights

# Next Steps and Latest Developments

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- On August 5, 2022 the STB Office of Environmental Assessment (OEA), issued a draft Environmental Impact Statement concerning the CP acquisition of KCS. Overall,” *based on consultation with federal, state, and local agencies; consultation with tribes; input provided by organizations and the public; and its own independent environmental analysis, OEA has concluded that, apart from train noise, which could result in adverse impacts at some locations, the potential adverse impacts of the Proposed Acquisition would be negligible, minor, and/or temporary*”
- The issuance of this draft EIS was followed by a series of in-person public meetings, online public meetings, and the OEA requested written comments by October 14, 2022
- The STB held public hearings September 28-30, and extended them into the following week, and final briefs were to be filed by October 15, later extended to the 21st – a final decision is anticipated in early 2023